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Opportunity Zones:
Mobilizing Private Capital for Public Good

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Opportunity Zones:
Mobilizing Private Capital for Public Good

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Abstract

Opportunity Zones:
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Opportunity Zones are a provision of the 2017 Tax Cuts and Jobs Act aimed at incentivizing private investment in economically distressed communities across the United States. By offering tax incentives to investors, the federal government hopes to tap into a market of over $6 trillion in unrealized capital gains to benefit urban and rural communities. This program has the potential to be a win-win for everyone: investors receive significant tax breaks, communities benefit from investments, and the government helps to attract more capital than it could itself provide to these areas. The challenge is in implementation, which has skewed towards flexibility for investors and fund managers with little to no accountability or guarantee of benefit for communities.

This report examines how Opportunity Zones relate to and build on a history of funding economic development through tax expenditures and place-based policies. Interviews with economic development staff in city- and county-level institutions reveal how urban and rural communities across Texas are responding to and taking advantage of the Opportunity Zone program. While larger cities are adopting a variety of approaches to

developing their Opportunity Zones, small and rural communities are struggling to attract attention from investors. The purpose of this report is to analyze how Opportunity Zones fit into a broader context of economic development in the U.S., identify potential benefits and challenges of the program, and highlight early strategies adopted by both urban and rural Texas communities.

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Introduction

The 115th United States Congress passed the Tax Cuts and Jobs Act (TCJA) in December 2017. Though the primary focus of the legislation was on individual and corporate income taxes, a lesser known provision called Opportunity Zones (OZs) slipped through the landmark tax bill. OZs are a federal tax incentive designed to attract private capital to low-income communities in need of reinvestment and revitalization. As the first federal economic development initiative passed in over a decade, OZs are significant for their renewed attention on place-based development and for their potential to unlock billions in private capital for low-income communities with the greatest need.

To incent investment, OZs offer a variety of tax benefits in order to mitigate risks for investors supporting development and economic growth in communities that typically do not have access to stable financial capital. According to the Economic Innovation Group (EIG), a bipartisan policy and advocacy group focused on economic growth in the U.S., OZs offer three primary benefits to investors: 1) a temporary tax deferral on capital gains invested in an Opportunity Fund that makes equity investments in designated low-income communities, 2) a step-up in basis on the original investment in Opportunity Funds held for five or seven years, and 3) exclusion from capital gains tax liability for new Opportunity Fund investments held for 10 or more years (EIG, 2019). There is no limit on the amount of capital gains that can be invested in an Opportunity Fund. In 2018, EIG estimated over $6 trillion in unrealized individual and corporate capital gains that could be eligible for investment in OZs (EIG, 2018a). For investors with unrealized capital gains who are willing to make long-term investments, OZs offer incentives to move that capital into investments benefitting distressed communities while also receiving significant tax breaks on existing and future capital gains.

Which communities stand to benefit from Opportunity Fund investments? Over 8700 low-income Census tracts across all states and U.S. territories, including Puerto Rico, were officially designated as Opportunity Zones in 2018. The definition of low-income community comes from Section 45D(e) of the U.S. tax code first created for regulations on New Market Tax Credits in 2000. Eligibility as a low-income community requires that a Census tract have at least a 20% poverty rate or a median family income that is 80% or less than the median family income of the state or surrounding metropolitan area (New Market Tax Credits, 2000). While the tax incentive is offered at the federal level, the process for designating OZs was left to governors, who had broad authority to select OZs in their communities based on any criteria beyond poverty rate. In the spring of 2018, all governors submitted 25% of their states' eligible low-income Census tracts to the Department of Treasury and IRS for approval as OZs.

Because the TCJA provided governors with flexibility in OZ designations, there was a wide variety of approaches and criteria used to select OZs across the states. Some states such as Colorado and California underwent rigorous processes to forecast demographic and economic changes, to seek public input on high-need Census tracts, and to identify criteria by which designations would be made (CA Opportunity Zones & Colorado Office of Economic Development and International Trade). Other states chose their OZs via a less structured or less transparent process. The Office of the Texas Governor selected 628 Census tracts across the state based on "chronic unemployment, natural disasters within the last two years, and low population density" (Perlmeter, 2018). In interviews conducted for this report, some Texas city officials stated that they sent recommendations of areas in their jurisdiction to the governor's office for designation, while other city officials became aware of OZs after the governor selected Census tracts in their communities. In theory, OZs can be a flexible tool for local and state officials to leverage towards meeting their communities' needs and catalyzing economic growth aligned to their strategic priorities; however, the ability of OZs to incentivize development in distressed communities first depended on the ability of states to identify and select areas most in need rather than communities already experiencing growth and development.

Analyses of the 8700 OZs selected across the U.S. indicate that, on average, the chosen areas demonstrated greater levels of distress than the required minimum poverty levels. Gelfond and Looney (2018) of the Brookings Institution found that the average poverty rate in selected OZs was 29%, though there was more variation in the extent to which states selected their highest need communities for OZ designation. EIG (2018b) found that OZs are home to over 31 million people, 24 million jobs, and 1.6 million businesses. Along several other dimensions, including employment growth, availability of development sites, and median family income, the selected OZs demonstrated a level of distress greater than communities not chosen (EIG, 2018b). In Texas, Governor Abbott designated 628 OZs across the state, though many areas were concentrated in East Texas and in parts of the state most affected by Hurricane Harvey in 2017. The average poverty rate in Texas OZs is 28%, and over 60% of Texas OZs are partially or fully rural (Perlmeter, 2018). Overall, these demographics and economic indicators show that, on average, OZs selected across the country and in Texas exhibit high levels of need and economic challenges. To meet the federal government's policy goals and intention for OZs, states first needed to identify areas with true distress and need for economic development. By selecting distressed communities, governors set the table for investments in areas with significant need for reinvestment and renewal.

However, designation as an OZ does not guarantee deal flow or investment dollars. As a market-driven incentive, OZs will only work if investors can identify investments that will generate economic benefit and favorable returns. Some communities, particularly those in growing metropolitan areas, already have social, economic, and demographic factors that attract the attention of investors, developers, and businesses. Other communities will need to be more proactive in attracting private capital and offering potential projects ready for development. Strategies used to leverage OZ benefits will differ between urban and rural communities. Though OZs are a federal economic development initiative, local communities are critical to the success or failure of this program.

RESEARCH SCOPE AND PURPOSE

The purpose of this report is to contextualize OZs within a broader narrative of economic development in the United States and to highlight different OZ strategies across communities in Texas. The first chapter reviews the use of tax incentives, such as the New Markets Tax Credit, to drive economic and community development in the United States. Next, the report examines past federal economic development programs such as Enterprise Zones, Empowerment Zones, and Renewal Communities to identify ways that past experience can inform current OZ implementation. Finally, this report details the potential benefits and challenges of OZs and highlights how Texas communities are making use of OZ benefits for their residents and areas in need. Information in this report is based on interviews with city- and county-level economic development officials, community development groups, and OZ thought leaders. While the personal identities of those interviewed will remain anonymous, the communities that they represent include: Austin, Brownsville, Dallas, Houston, Lubbock, Orange, San Antonio, Texarkana, and Tyler.

Chapter 1: The Use of Tax Incentives in Economic Development

Though the tax benefits offered by OZs are significant, the use of tax incentives to mobilize private capital in low-income communities is not novel. Due to declining public investment in public goods and infrastructure at all levels of government, tax incentives are one avenue by which the public sector attracts private investment in communities.[1] Tax expenditures, including specific types of tax credits, providing benefits to particular taxpayers offer an indirect way to invest in projects and goods that provide some level of economic boost to businesses and communities. The New Markets Tax Credit (NMTC) is one example of a federal tax expenditure focused on revitalizing low-income communities across the country. Evaluations of the effectiveness of NMTC show mixed results in the social and economic outcomes generated by tax incentives. As OZ stakeholders look forward, it is important to consider the extent to which tax benefits can catalyze the growth and change that distressed communities truly need.

DECLINING PUBLIC INVESTMENT IN DISTRESSED COMMUNITIES

In a resource-limited environment, public sector actors may seek to collaborate with or leverage private sector capital to maximize investments in public goods and communities. Public sector investments in infrastructure and public goods occur at the federal, state, and local levels. At the federal level, the Congressional Budget Office (CBO) defines federal investment as spending in "physical capital, education, and research and development [that] boosts private-sector productivity gradually" (Congressional Budget

[1] It is important to note that the federal government offers many types of tax incentives and exemptions that are categorized as tax expenditures. For example, investors can receive exemptions from federal taxes on interests derived from investments in municipal bonds, many of which support local infrastructure or economic development projects. Investor returns are based on the government's ability to repay the bond. While also considered a tax expenditure, OZs or NMTCs are different in that investors become equity owners of projects, and their returns are based on the success of those projects.

Office, 2016). By improving the quality of public goods such as transportation and increasing training within our workforce, the federal government supports the growth of private sector businesses and economic return for the country. Most of this investment is done through the federal government's discretionary spending, which represents about 30% of the federal government's overall budget (National Priorities Project). The majority of the federal budget goes towards mandatory spending items such as Social Security and Medicare. Given how little of the federal budget goes towards discretionary spending, deciding what investments to make can be a political and contentious process.

Over half of the federal government's discretionary spending goes towards military and defense spending, leaving much less of the budget available for investments in physical infrastructure and education/workforce initiatives (National Priorities Project). In 2012, the CBO estimated that the federal government spent $531 billion on investments (including physical infrastructure and education), which is equivalent to 15% of all federal spending (CBO, 2013). Compared to other national priorities, investment in the types of projects and initiatives with a direct impact on business growth and day-to-day life of Americans is relatively small. The challenge is that the small share of federal spending on investments continues to decline. Non-defense discretionary spending in 1970 amounted to 2.5% of GDP, but has since declined to 0.5% of GDP in 2014 (Malinovskaya & Wessel, 2017). Investments in physical infrastructure as well as education and training are central to the long-term growth and productivity in the U.S. economy. Yet, the federal government spends less on public investments as a share of GDP today than it did over 40 years ago.

Furthermore, spending on infrastructure also decreased at the state and local level in the same timeframe (Malinovskaya & Wessel, 2017). In the absence of federal spending on infrastructure and other nondefense items, states can improve the quality of their roads, education systems, and other assets by increasing their own level of funding. Again, public investments directly and indirectly lead to more jobs, better quality of living, and economic growth. The Center on Budget and Policy Priorities notes that most states chose to cut taxes rather than increase their level of investment in infrastructure needs at the same time that the federal government decreased its own investments in public infrastructure (McNichol, 2019). The decline in state-level investment in infrastructure not only threatens future innovation and growth but also leaves current infrastructure in need of significant repair. While investment in infrastructure varies by state, overall investment in critical physical assets and workforce training limit economic growth across the public and private sectors.

FUNDING PUBLIC GOODS THROUGH TAX EXPENDITURES

Though direct government spending on infrastructure has declined, the public sector is able to indirectly support growth by offering tax credits and tax exemptions to key groups of stakeholders in order to facilitate economic growth. The Tax Policy Center at the Urban Institute and the Brookings Institution defines tax expenditures as "special provisions of the tax code such as exclusions, deductions, deferrals, credits, and tax rates that benefit specific activities or groups of taxpayers" (Tax Policy Center). These provisions can be made to create favorable economic gains and breaks for key groups of people or political constituencies; however, tax expenditures are also a way for the government to subsidize important activities or stakeholders that may contribute positively to the economy or public infrastructure. Tax expenditures offer an indirect way for the government to support certain groups, projects, or programs rather than providing direct funding itself (Tax Policy Center). Groups receiving preferential treatment can be as broad as taxpayers with children or as narrow as renovators of qualified historical buildings. There are many types of tax expenditures, including credits, deferrals, exclusions, and deductions. The capital gains tax deferral and exclusion offered to investors in Opportunity

Zones are an example of tax expenditures from the government. Supporters of tax expenditures believe that they offer local and state officials with greater flexibility in targeting investments towards community priorities and accounting for local context in implementation. Direct investments from the federal government may become too bureaucratic and too dependent on political support to sustain long-term projects. By providing more autonomy to local and state officials, tax expenditures allow for more diversity in projects supported and less administrative burdens in implementation.

However, tax expenditures are not universally supported. Many believe that the federal government forgoes an excessive amount of potential tax revenue by offering tax expenditures to special groups of taxpayers. According to the Center on Budget and Public Policy Priorities (2018), all tax expenditures cost the federal government more than its entire discretionary funding budget, reducing federal income tax revenue by $1.5 trillion each year. Tax expenditures exist because the federal government believes that providing benefits to taxpayers or projects fulfills some kind of priority for the government; however, the cost of tax expenditures to the government is so great that it begs the question whether the government could directly fund or support its own priorities if it did not give up so much in tax revenue each year. Those who believe that the private sector can better fund policy priorities may think that tax expenditures are a way to be more efficient with limited resources. Opponents to tax expenditures often argue that these special benefits accrue to wealthier taxpayers in higher income brackets with the top fifth of the income bracket receiving 61.9% of individual income tax expenditures (Center on Budget and Public Policy Priorities, 2018). The disproportionate preferential treatment for higher income taxpayers means that the government not only misses out on significant tax revenue but also does not support the low-income or middle-class taxpayers that need the most support.

Interestingly, the federal government offers several tax credits aimed at supporting and revitalizing low-income communities. The credits are geared towards investors who are willing to fund projects and support businesses in low-income, low capital communities that are typically considered risky for investments. One example is the Low-Income Housing Tax Credit (LIHTC) created in 1986 to incentivize real estate developers to create affordable housing (26 U.S. Code § 42). The Historic Tax Credit (also known as the Rehabilitation Credit) created in 1966 subsidizes renovation of historic buildings, which many developers can use to make the revitalization of old buildings in distressed areas more economically attractive (26 U.S. Code § 47). Aligned closely with the policy goals of OZs, the New Markets Tax Credit (NMTC) was created in 2000 to incentivize private sector investment in distressed communities. NMTC and OZs both recognize a need for increased private capital in areas that typically have difficulty attracting investments needed to boost economic growth and job creation for those most in need. Recently, President Trump's economic advisers, Peter Navarro and Wilbur Ross, hinted at a more specific tax credit for infrastructure investment by private investors, but a formal proposal has not been released (Babbage, 2017). These credits are aimed at incentivizing the private sector to rebuild and reinvest in communities that have been left behind.

Compared to other tax expenditures, these tax credits aimed at economic development in distressed communities are far from the costliest tax expenditures offered by the federal government (Novogradac, 2017). The largest federal tax expenditures are a tax inclusion for employer-sponsored health insurance ($172.8 billion between 2017-2021), reduced tax rates on long-term capital gains ($127 billion), and a tax credit for children and other dependents ($121.7 billion) (Tax Policy Center). In comparison, the LIHTC is expected to cost about $45 billion in the same time period while the NMTC will cost about $6 billion (Joint Committee on Taxation, 2018). Overall, these community development tax expenditures are a relatively inexpensive and indirect way for the government to support investments in infrastructure and programs needed to support economic growth in communities where development is most difficult.

A Comparison of New Markets Tax Credits and OZs

Though the tax benefits offered by the New Markets Tax Credit are not the same as those available in OZs, the two programs share similar policy goals of incentivizing private investment in low-income communities. NMTC was created in 2000 by Congress to incentivize investment from corporate entities and financial institutions in communities typically unable to attract investment for key economic development programs or infrastructure. Evaluations of NMTC found mixed outcomes of effectiveness in revitalizing distressed areas; however, this data can inform OZ implementation in similar communities in need of private investment.

Before reviewing evaluations of NMTC, it is important to understand how the program is similar to or different from OZs. Congress created NMTC because it recognized a need to attract private investment, especially in the face of declining public investment, in low-income communities considered unattractive or risky areas for investors to support. In an era of increasing partisanship, it is noteworthy that both programs enjoy widespread bipartisan support. To make investing in low-income communities more feasible, NMTC offers investors a tax credit equivalent to up to 39% of the project value over a 7-year period towards their federal income tax (Tax Policy Center). The definition of a low-income community under NMTC is the same definition used for OZs: 20% poverty rate within a Census tract or no more than 80% of the median income of the surrounding metropolitan area. Investors hoping to receive NMTC or OZ benefits are required to make equity investments in low-income communities. In essence, NMTC and OZs share a goal of revitalizing a similar set of distressed communities across the country by incentivizing private investment.

The biggest difference between NMTC and OZs is the level of funding and administration provided by the federal government towards implementation of NMTC. NMTC is a federal program centrally administered by the Internal Revenue Service (IRS) and the Community Development Financial Institutions (CDFI) Fund, which allocates a limited amount of tax credits each year among local Community Development Entities (CDEs) acting as intermediaries between private investors and local businesses. CDEs must apply for tax credits from the CDFI Fund through a competitive application process with criteria such as the extent of distress in a community and how much of a business' revenue and workforce comes from the low-income community (U.S. Bank). The presence of CDEs as a local intermediary with an understanding of local conditions and community needs is a differentiating factor between the NMTC and OZ programs. While private investors make equity investments in the CDE, the CDE is ultimately responsible for providing loans or equity investments to businesses in low-income communities. They direct where the funding goes, which community priorities are supported, and track the results of NMTC-incentivized funding in their communities. Furthermore, obtaining certification as a CDE is a rigorous process with standardized requirements and approval by the CDFI Fund, which looks for organizations that share its goal of promoting community development and economic growth in the nation's most distressed neighborhoods. CDEs must be governed by an advisory board with at least 20% of its membership from the low-income community that it serves (Federal Register, 2001). The NMTC program also requires extensive reporting and accountability measures to track what projects are supported, who benefits from these projects, and what outcomes result from the investment.

At the time of publication of this report, implementation of OZs is still in a nascent phase. Many investors, developers, community agencies, and local governments are awaiting final guidance and regulations from the IRS about OZs. However, what the regulations have laid out in the first 16 months of the program indicates that the level of oversight from the federal government over OZ implementation will be minimal. To invest in low-income communities, investors must make investments into an Opportunity Fund, which then supports projects in a designated OZ. Any entity can fill out a 2-page form (Form 8996) to self-certify as a Qualified Opportunity Fund, which does not require IRS approval to begin making investments in OZs (Internal Revenue Service, 2018). Investors and developers seeking to unlock OZ benefits must source their own projects, but do not need to work with a local intermediary or organization to better understand community needs. For communities in less attractive markets (such as many rural areas), the lack of a local intermediary can be a hindrance to development because investors may not be aware of potential projects or do not have access to deal flow put together by entities with more knowledge of local conditions. For communities in attractive markets, investors and developers are likely to already be aware of projects and may be able to bypass community development organizations hoping to attract investment for specific projects or community priorities. As of April 2019, the IRS does not require any reporting on investments made in OZs, though they are seeking public input on potential reporting requirements for their third round of OZ regulations.

Comparing the implementation of NMTC and OZs (thus far), it is clear that NMTC is administered as a program of the federal government with resources for administration, accountability, and evaluation. Thus far, OZs, which fall under the purview of the IRS, have minimal requirements and ways to ensure that investments made in low-income communities actually result in the kinds of development needed in distressed areas such as job creation, growth of small businesses, and social or healthcare facilities. As of spring 2019, the IRS is soliciting public input on reporting requirements that can help evaluate what OF investments are made and what community benefits result from the OZ program.

Reviewing the Effectiveness of NMTC

Since implementation of OZs is still unfolding, it is too early to measure any signs of effectiveness towards fulfilling the program's policy goals of revitalizing low-income communities. Given similar goals and intended outcomes of NMTC, reviewing evaluations of the NMTC program can identify potential challenges and highlight best practices in community development for OZ implementation.

According to the CDFI Fund, CDEs raised over $48 billion in private investments between 2002 and 2018 to support over 5900 businesses in "severely distressed" communities across all 50 states, the District of Columbia, and Puerto Rico (CDFI Fund, 2018b). A wide variety of projects have been financed by NMTC ranging from real estate developments to alternative energy programs and small business development. Furthermore, the CDFI Fund estimates that over 750,000 jobs have been created through NMTC programs and initiatives since 2003 (CDFI Fund, 2018a). On the overall impact of the NMTC program, the CDFI Fund (2018a) states:

> For every $1 invested by the Federal government, the NMTC Program generates over $8 of private investment. The NMTC Program catalyzes investment where it's needed most – nearly 75 percent of New Markets Tax Credit investments have been made in highly distressed areas. These are communities with low median incomes and high rates of unemployment, and the NMTC investments can have a dramatic positive impact. (p. 2)

While a significant amount of investment has gone towards distressed communities, the evidence of both community and economic impact is less clear. A metanalysis of several economic development incentives aimed at attracting private sector businesses found that most incentives have no, or at best, marginal effects on investments, job creation, or community revitalization (Peters & Fisher, 2004). Local and state governments often offer significant amounts of tax benefits to firms in the hopes that these additional incentives will attract new businesses, catalyze additional investment, and create new jobs. In reality, tax incentives alone are often not enough to pull businesses to a location, as businesses tend to consider a broader set of issues including state corporate tax rates, local tax rates, and the quality of public services in a community (Peters & Fisher, 2004; see also Rainey & McNamara, 2002; Harger et al., 2019). Though the metareview focused on a variety of incentives, including tax credits, the results across multiple studies indicate that these benefits for businesses are not enough to create the transformational change that economically distressed communities need.

Evaluations of the NMTC program show similar findings. Though the NMTC program intends to catalyze significant private sector investment and create lasting community outcomes, many studies show that there are positive benefits to NMTC, but not at the level expected by policymakers and community development advocates. Overall, there is evidence to show that the NMTC program does result in increased investments in low-income communities, though there is unclear evidence as to whether this is because of the relocation of investments from some communities to others, or if this the result of an overall increase in investment (Harger & Ross, 2016; see also Abravanel et al., 2013; Gurley-Calvez et al., 2009). Some studies show that NMTC do not generate significant and long-term effects on the overall well-being of residents because they are a "shallow subsidy" that can decrease some of the risk for investors in distressed communities, but is ultimately not enough to substantially change investor behavior (Gurley-Calvez et al., 2009; see also Peters & Fisher, 2004; Rainey & McNamara, 2002). NMTC may shift investments from other low-income communities to those eligible for the tax benefits, but there may not be an overall increase in the amount of investment by corporate or individual investors (Hula & Jordan, 2018). NMTC sweeten deals that likely would happen with or without the tax incentive. Gurley-Calvez et al. (2009) find that corporations investing in distressed communities do so because of other motivations, such as compliance requirements with the Community Reinvestment Act, while individuals invest because of philanthropic motivations, not a desire to pursue great economic return.

One possible explanation for investor behavior is the short timeline required to unlock the full benefits of the tax credits. Hula & Jordan (2018) suggest that investors choose projects that would happen with or without the incentives because they can only receive the NTMC if a project closes within 12 months; therefore, investing in projects that require a longer development timeline is economically unattractive. Tapping into an existing pipeline of projects that have been identified and are ready for development is easier than going through a long process to engage stakeholders, identify community priorities, and develop projects that may have more significant impact in the long-term. To expedite deal closings, investors often bring potential projects to CDEs for approval rather than CDEs identifying community projects for investments (Hula & Jordan, 2018). This is the antithesis of the intended implementation of NMTC, which must go through local CDE intermediaries that have knowledge of community needs and act in the interest of low-income residents.

Furthermore, studies have shown that NMTC do not generate significant community impact, as measured by decreased poverty rates, increased job creation, or increased median income levels. Freeman (2012) finds that for every $1 million in NMTC investments, median household incomes increase 0.02% and unemployment falls by less than 0.1%. Given the magnitude of social and economic challenges in NMTC-eligible communities, this return on investment is insufficient to revitalize communities in a meaningful way. NMTC investments can result in some benefits to communities such as a small increase in median home values; however, positive changes result from changes in the resident population rather than improved quality of life for current community members (Freeman, 2012). The evidence is unclear if NMTC investments contribute to some level of displacement, attracting new residents who tend to be wealthier than those that they replace, or if the program generates positive benefits for existing residents. Hula & Jordan (2018) find that NMTC investments can create new jobs, but many of these jobs are associated with the construction of real estate projects, making them temporary additions to the community. Economically distressed areas with high unemployment rates need job creation, but they need jobs that provide sustainable employment and wages to residents of the community.

Even though the NMTC funnels a significant amount of capital into economically distressed communities, the community impact of said investments is limited. Most of these investments go to projects that would be funded regardless of the tax incentive. Small improvements in community outcomes are often the result of new residents moving into the area, not a marked improvement in the lives of low-income people residing in the community prior to the investments. Severely distressed communities face a myriad of challenges that may be too great for a tax incentive to solve on its own. While these credits can sweeten deals for private investors, they are not enough to create the level of transformational change needed to revitalize distressed areas of our country. This raises an important question about the purpose and effectiveness of subsidizing economic development at all, especially if tax incentives tend to support projects likely to proceed with or without government support.

IMPLICATIONS FOR OPPORTUNITY ZONES

What lessons can the NMTC program offer for OZ implementation? Though the programs offer different tax incentives to private investors, they share a common policy goal of revitalizing low-income communities. Those interested in OZs should look to the NMTC program for both best practices and warning signs:

- Government resources for program implementation: Achieving lofty goals of revitalizing distressed communities and creating meaningful impact for low-income residents does not happen by accident. The NMTC program demonstrates that administrative infrastructure is important for implementation of complicated tax and legal incentives. Combining central administration at the CDFI Fund and local CDE intermediaries with on-the-ground knowledge is vital to tracking program outcomes, providing technical assistance to potential investors, and ensuring that projects address community needs. Early guidance from the IRS on OZs suggests that the administration intends to adopt a minimal approach to implementation, jeopardizing the long-term success of OZs. Lack of clarity and support from the IRS makes it difficult for local governments to prepare for investments and makes investors more hesitant to invest without a clear understanding of how this works (Browning, 2019). The federal government's reluctance to put more substantive resources behind program implementation and tracking jeopardizes the ability of OZs to work for investors and communities alike.
- Local community intermediaries: Unlike NMTC, OZs offer no formal role or authority for any local or state entities in implementation. Local governments, economic development corporations, or community development corporations have no way to track or monitor investments flowing into their communities. Investors can make significant investments in OZs without any coordination with local entities. Proponents

of OZs believe that a lean approach to implementation may ease the flow of capital into communities without administrative hurdles; however, offering local stakeholders no formal role in implementation makes it easier for investors to bypass community needs to invest in projects purely for economic return. Rather than view local engagement as a barrier to investment, OZ supporters should think of coordination with local entities as a way to help mitigate risks and to anticipate development challenges.

- Unintended consequences of expedited timelines: Both the NMTC and OZ programs require investments to flow to local projects within a quick timeline. Once NMTC investors are made into a CDE, these funds must be distributed to a qualified project within 12 months. As stated before, this timeline incentivizes investors and developers to select projects already in the pipeline or easier to close than investments that require a longer planning process (Hula & Jordan, 2018). The timeline for OZs is even shorter. OZ investors have 180 days to reinvest capital gains realized by the sale of their investment(s) into an Opportunity Fund, which then must invest in projects within six months (Novogradac, 2019). While this in itself may not be a big issue, investors must invest in an Opportunity Fund by the end of 2019 to qualify for the full benefits of the OZ program. As of spring 2019, the IRS released two tranches of regulations and is expected to release at least another tranche in the future. If investors want to access the full suite of OZ tax benefits, then they will most likely need to decide if and where to invest soon, which may curtail the time available to explore investment opportunities, conduct due diligence, and make investments. Coupled with the continued lack of clarity from IRS guidance, this short timeline to identify potential deals, raise funds, and distribute the funds to qualified projects likely dampens the level of investments in low-income communities. Aligning all of these pieces and stakeholders take time, and the current runway provided for OZ investments does not set up investors or local communities for mutually beneficial success.

- Need for a broader economic development strategy: Finally, the evidence of mixed to no meaningful outcomes from tax incentives indicates that tax incentives alone are not enough to revitalize distressed communities. While tax credits, exemptions, or deferrals can sweeten the deal for some investors, they are not enough to significantly alter investor behavior or the level of investment made in low-income communities (Peters & Fisher, 2004). It will likely take a broader, integrated economic development strategy, of which tax incentives are one tool, to make meaningful change in economically distressed communities. Tax incentives are not a panacea. Investors will require more than tax breaks to attract them to distressed communities, and local economic development officials will need to layer several incentives and strategies to move the needle on social and economic outcomes in these areas. While programs such as OZs are important, they are one tool for incentivizing economic development but unlikely to be a silver bullet for economically distressed communities.

Chapter 2: History of Place-Based Economic Development in the U.S.

Another trend in community revitalization and economic development is a focus on place-based initiatives. Instead of targeting social and economic supports to a group of people, many federal economic development initiatives focus on a limited set of communities and deploy a variety of incentives and investments to revitalize the geographic area. These communities can be defined by Census tract, neighborhoods, or even entire cities. Place-based revitalization efforts allow federal, state, and local governments to layer different incentives, attracting both significant public and private investments to address community needs in an integrated manner. Since the 1990s, the U.S. government has focused on target, place-based economic development strategies. OZs are the latest iteration of place-based development in the U.S. offering many similar incentives as past programs. This chapter focuses on the history of recent place-based development programs and the lessons they offer for OZs.

ENTERPRISE COMMUNITIES AND EMPOWERMENT ZONES

Authorized by the Omnibus Budget and Reconciliation Act of 1993, the Enterprise Communities (ECs) and Empowerment Zones (EZs) were created to incentivize development in both urban and rural distressed communities across the country. According to a review of the programs by the Government Accountability Office (GAO) in 2010, the programs "offered a mix of grants and tax incentives for community and economic development" to meet the goals of "revitalizing high-poverty, economically distressed communities" (GAO, 2010). The programs were created at the same time to address the same policy goals, but they differ in the mix of government grants and tax incentives offered to investors and local communities. It is important to note that the government intentionally designated both urban and rural areas through a competitive application process through which communities submitted strategic plans for fostering economic growth and reducing poverty and unemployment.

Though the U.S. first developed a place-based approach to community development in 1993, the idea originated in the UK the 1970s and 1980s under Margaret Thatcher's premiership to incentivize capital investments in former industrial areas and communities (Gunther & Leathers, 1987). The concept championed free market principles and removed government tax barriers and regulations to allow for more private investments in inner city neighborhoods. Decreased government regulations, increased free market activities, and more flexibility for local control in economic development made its way across the pond as several states enacted their own Enterprise Zone programs (Bondonio & Engberg, 2000). Because the principle behind Enterprise Zones focuses on locally-driven, market-based development, states and cities have maximum flexibility to focus on their priority areas and to incentivize developments towards fulfilling local needs. At the same time, the Reagan administration focused on a smaller role for government in community development in favor of market-driven incentives and approaches. Eventually the proliferation of state Enterprise Zones and the shift to market-driven economic development led to the passage of a federal EZ program in 1993.

The Omnibus Budget Reconciliation Act of 1993 created both the EZ and EC programs, which share a policy goal of revitalizing economically distressed areas but differ in the types and amounts of incentives offered to investors and local governments. EZs offered broad incentives, including tax credits to businesses employing local residents, deductions for capital investments made by businesses, bonds with low or no interest rates for construction, and capital gains deferral and exclusion incentives for investors (GAO, 2010). Congress also authorized over $720 million under the Social Services Block Grant to support residents of EZs and over $210 million in Community Development Block

Grants for the first round of designated EZs (Congressional Research Service, 2011). The combination of block grants and tax incentives was meant to infuse a significant amount of resources in high-need communities to spur economic growth and to improve the lives of residents.

Similar to the Empowerment Zones, Enterprise Communities (ECs) also offered a variety of grant and tax incentives to spur development in distressed communities. The key differences in the programs were the amount of resources authorized and the types of incentives offered. ECs provided credits for employment of youth in local communities, low interest bonds for construction, and block grants from the federal government (GAO, 2010). Because ECs were smaller than EZs, the amount of grants authorized to support ECs was also smaller with $280 million in Social Services Block Grants and $88 million in Community Development Block Grants (Congressional Research Service, 2011).

Four federal agencies were responsible for joint administration of the programs with HUD managing the urban communities, USDA managing rural communities, HHS overseeing block grant funds, and IRS administering tax benefits (GAO, 2010). To be eligible for federal support, local governments and states could nominated areas for designation based on poverty, unemployment, and population size. Through a competitive application process, the four federal agencies evaluated local and state strategic plans with Secretary of HUD making the final selection of EZs and ECs. The first round of designations resulted in the selection of six urban EZs (Atlanta, Baltimore, Chicago, Detroit, New York City, and Philadelphia/Camden), three rural EZs (Kentucky Highlands, Mid-Delta Mississippi, and the Rio Grande Valley in Texas), 65 urban ECs, and 30 rural ECs (Congressional Research Service, 2011). Over the course of the programs, three rounds of designations were made between 1994 and 2000, resulting in 45 EZs and 115 ECs receiving community development benefits and incentives.

RENEWAL COMMUNITIES

Like EZs and ECs, Renewal Communities (RCs) were created in 2010 through the Community Renewal Tax Relief Act to revitalize economically distressed areas. Designations of RCs were made through a competitive application process similar to the one used for EZs and ECs using criteria around poverty, unemployment, and population. One difference in the designation processes used among these programs was that applicants for RC designation did not have to submit a comprehensive strategic plan. Instead, they provided federal agencies with a "course of action" with key activities that the community would take to address social and economic needs in the area (GAO, 2010). Table 1 shows the differences in program eligibility between EZs, ECs, and RCs by urban and rural areas as well as designation round. There was only one round of RC designation, resulting in the selection of 28 urban RCs and 12 rural RCs.

EZ/EC/RC Eligibility Requirements by Program Round

	Urban EZ/EC		Rural EZ/EC		RC
	Round I	Rounds II and III	Round I	Rounds II and III	
Minimum required poverty level in nominated census tracts[a]	35% in half of tracts, 25% in 90% of tracts, and 20% in all tracts[b]	25% in 90% of tracts, 20% in all tracts[b]	35% in half of tracts, 25% in 90% of tracts, and 20% in all tracts[b]	25% in 90% of tracts, 20% in all tracts[b]	20% in all tracts[c]
Minimum required unemployment rate	6.3% (1990 national rate)[a]	6.3% (1990 national rate)[a]	No minimum specified; could be demonstrated by several different indicators		9.45% (1.5 times the 1990 national rate)[a]
Required population[a]	Maximum: 200,000 or the greater of 50,000 or 10% of the population of the most populous city within the nominated area Minimum: None		Maximum: 30,000 Minimum: None		Maximum: 200,000 Minimum: 4,000 if any portion lay within a metropolitan statistical area of 50,000 or greater; 1,000 otherwise, except for areas entirely within an Indian reservation, which had no population restrictions
Maximum required area[a]	20 square miles[d]	20 square miles, with up to 3 developable sites[d,e]	1,000 square miles[d]	1,000 square miles, with up to 3 developable sites[d,e]	None, but area boundary must be continuous
Conditions of general distress	6 indicators, such as high incidence of crime or narcotics use and amount of abandoned housing	17 indicators, such as average years of school completed, number of persons on welfare, and dropout rate	14 indicators, such as average years of school completed and incidence of crime or narcotics use		17 indicators, such as average years of school completed, number of persons on welfare, and dropout rate
Other requirements	Strategic plan based on the four key principles of the EZ/EC program: (1) economic opportunity; (2) sustainable community development; (3) community-based partnerships; and (4) strategic vision for change				"Course of action" that committed to carrying out 4 of 6 activities (e.g., crime reduction strategies and an increase in the level of efficiency of local services within the RC)

Source: GAO summary of P.L. 103-66, P.L. 105-34, P.L. 106-554, 24 C.F.R. 597, 24 C.F.R. 598, 24 C.F.R. 599, and 7 C.F.R. 25.

Table 1: Program Eligibility Requirements for EZs, ECs, and RCs. Source: Government Accountability Office, 2010.

Unlike previous federal economic development programs, RCs offered a limited set of tax incentives and no federal block grants. The tax benefits provided by RCs included wage credits for employment of local residents, tax deductions for building rehabilitation and capital investments, exclusion of capital gains for assets held over five years, and other investment incentives (GAO, 2010). Administration of the RC program was much leaner than that of EZs and ECs because there was only one round of designations and only tax incentives were overseen by the IRS. Though EZs and ECs focused on broad elements of community development, RCs were more narrowly focused on supporting small to medium-sized projects through construction and rehabilitation of physical infrastructure (GAO, 2010). Table 2 shows the differences in tax benefits among the three different programs, though it is important to note that EZs and ECs received significant grant funding not captured in the table.

Summary of Tax Benefits	EZ	EC[a]	RC
Wage Credits			
Employment Credit – Annual tax credit for businesses of up to $3,000 or $1,500 for each employee living and working for the employer in an EZ or RC area, respectively.	X		X
Work Opportunity Credit – Business tax credit of up to $2,400 for each new employee age 18 to 24 living in an EZ/EC/RC, or up to $1,200 for a youth summer hire.	X	X	X
Deductions			
Commercial Revitalization Deduction – Accelerated method of depreciation to recover certain business costs of new or substantially rehabilitated commercial buildings in an RC (states allocate up to $12 million annually per RC)			X
Increased Section 179 Deduction – Increased deduction of up to $35,000 of the cost of eligible property purchases (including equipment and machinery) for businesses in an EZ/RC.	X		X
Investment Incentives			
Facility Bonds – Bonds issued for projects in EZs/ECs by state or local governments at lower interest rates to finance construction costs (up to $230 million in urban EZs).	X	X	
Qualified Zone Academy Bonds – No interest bonds issued in EZs/ECs by state or local governments to finance school programs, with purchasers receiving interest payments as tax credits.	X	X	X
Rollover of Capital Gains – EZ business owners may be able to postpone part or all of the gain from the sale of a qualified EZ asset that they hold for more than 1 year.	X		
Increased Exclusion of Capital Gains – Taxpayers can exclude 60 percent of their gain from the sale of small business stock in a corporation that qualifies as an enterprise zone business.	X		
Exclusion of Capital Gains – RC business owners can exclude qualified capital gains from the sale or exchange of a qualified community asset held more than 5 years			X

Table 2: Tax Incentives Offered Through EZs, ECs, and RCs. Source: Government Accountability Office, 2010.

Program Effectiveness and Impact

How effective were these programs in achieving their policy goals? Studies from both the Government Accountability Office and Congressional Research Service found mixed results. Evaluations of EZ, EC, and RC programs find little to no significant evidence of improved economic conditions as a result of the grant funding and tax incentives offered by the programs (Congressional Research Service, 2011). Some studies show that these programs have led to small reductions in poverty level and unemployment; however, these changes cannot be attributed to the EZ, EC, or RC programs alone (GAO, 2010). There is some evidence that designation as an EZ can increase property values in an area, which makes sense if EZs were designated, in part, due to infrastructure and community development assets that could help spur economic growth (Hanson, 2009). However, the same study shows mixed results on the effects of EZs on the employment and poverty rate of residents. Designated communities, some of which are quite large and complex, are affected by numerous factors which can influence economic growth or community change. Given the magnitude of challenges in many of these communities, several disparate components under one program may not be comprehensive enough to create substantive change in community economic conditions.

Other explanations of the lack of detectable effectiveness include challenges in separating true program effects from broader economic changes (Congressional Research Service, 2011). Communities experience economic growth or decline due to changes in the condition of the national economy writ large. In a good economy, communities can experience economic growth based on factors unrelated to the grant or tax incentives provided by these federal programs. It is difficult to pinpoint whether these communities would have experienced growth and improvement on their own or whether the programs catalyzed the change. Alternatively, some studies have shown that improvements in social and economic conditions are the result of a change in the local population, not substantive improvement because of federal programs (Government Accountability Office, 2006). Reynolds & Rohlin (2015) found that EZs did not lift households out of poverty and that any improvements in income levels was more likely due to wealthier individuals moving into gentrifying communities, not a substantial improvement in the lives of those who were already in poverty. Displacement of low-income residents and an influx of wealthier residents can make it seem like the programs led to significant economic growth, but this could be interpreted as a failure of the program to achieve its goals of revitalizing economically distressed areas while also lifting up current residents.

Though evaluations of EZ, EC, and RC programs at a national level indicate mixed results, some research points to small improvements on a local level. Rich & Stoker (2010) found that unemployment, poverty, job creation, housing investment, and business investment between six different EZ cities improved or worsened at different levels. This suggests that local context and policies can play an important role in the overall effectiveness of economic development programs. Variation in program implementation, including who is responsible for administering federal programs at the local level can make a difference in outcomes. For example, Chicago and Philadelphia implemented EZ incentives through existing city agencies while Atlanta, Baltimore, Detroit, and NYC created separate nonprofits to oversee the EZ program (Rich & Stoker, 2010). This suggests that it may be too simplistic to rely on national-level evaluations of large-scale federal economic development programs, especially when local context and policies is crucial to how programs are implemented.

Results from evaluations of the EZ/EC/RC programs mirror many of the findings from evaluations of the NMTC program. As stated in Chapter 1, it takes more than marginal tax credits to incentivize investments in low-income communities from private investors, who are risk averse and profit driven. Between 1993 and 2009, Congress appropriated $1.78 billion in grant funding for EZs and ECs along with extensive tax credits across all three programs (Congressional Research Service, 2011). Mixed and inconclusive results about the effectiveness of these programs in improving communities is partially due to the fact that little data, if any, were collected by federal agencies on the use of program funds or any other monitoring requirements (GAO, 2006). The GAO repeatedly cites the lack of data collected through the duration of the programs as a major hindrance to the ability to evaluate whether and what kinds of impact the programs may have had on the country's most distressed communities. The inability to measure or to attribute positive results to the federal programs begs the question: is this the most effective and efficient use of limited government resources?

COMPARISON TO OPPORTUNITY ZONES

OZs are the latest evolution of a series of place-based federal economic development programs. Though the programs began with greater government oversight and funding, subsequent rounds of EZ/EC designations and the RC program stripped away grant funding in favor of tax incentives for private investors and businesses. OZs are an extension of that trend, as they offer only capital gains tax benefits to attract private investors to economically distressed communities. It is important to recognize similarities and differences between OZs and past federal programs.

Like its predecessors, OZs were created to revitalize economically distressed communities across the country. OZs focus on incentivizing private investments through tax benefits, including capital gains deferrals and exclusions. Similar incentives have been offered through the EZ, EC, and RC programs with mixed success. OZs are based on principles for local control and market-driven enterprise. Proponents of OZs state that local stakeholders have maximum flexibility to design and implement programs that address their unique community needs. Furthermore, market-driven incentives ensure that only communities able to attract investors and to provide some level of economic return will be successful in leveraging OZs for community benefit. At its core, OZs are like all previous federal programs in its policy goal of focusing on communities that have been left behind in economic growth and community development. OZs also adopt several core tenets that characterized some past programs: local flexibility, incentives for private capital, and market-driven program structure instead of government administered.

However, OZs are also different from past programs in key ways. Compared to previous federal programs, OZs offer a very narrow set of tax benefits to potential investors and developers. EZ/EC/RC investors received a broader set of tax benefits to employ local residents, fund construction projects at lower cost, and provide tax deferrals or exclusions for capital gains (GAO, 2010). In comparison, OZs are narrow in scope as they only offer capital gains tax deferral and exclusion benefits. OZ benefits accrue directly to investors and developers whereas past programs offered social services and assistance to improve the lives of residents. The level of program administration for OZs also differs significantly from that of past programs. Federal, state, and local governments have very little formal authority (if any) over the OZ program, which is administered through the IRS. From what interested parties have seen in the early stages of OZs, the IRS intends to keep its oversight of OZs to a minimum and are only responsible for OZs because of tax implications. If EZ/EC/RC were programs, then OZs are more of a tax incentive than a federal program.

Finally, the scope of these programs differs dramatically. Over the course of 10 years, a few hundred communities were designated as EZs, ECs, or RCs. Because OZs defines communities by Census tracts, there are over 8700 OZs ready for investment. This increases the market-driven aspect of the program, as some communities will attract investments and others will not. Past federal programs guaranteed that all communities designated as EZs, ECs, or RCs will receive some kind of grant and/or tax funding, but this is not the case for OZs. Being designated as OZs does not guarantee that any amount of money will actually flow into the communities and improve the lives of residents. There will be competition among OZs to attract investors, who have a lot more options about where they would like to invest their money.

On the other hand, one could argue that the EZ/EC/RC programs focused on too large of an area to be effective. As the program evaluations from the GAO (2010) and Congressional Research Service (2011) indicate, changes in the economic conditions of these zones could not be attributed to these federal programs alone. Perhaps the OZ program's focus on Census tracts rather than neighborhoods or entire cities may increase the likelihood of success, as it could allow for more targeted investment opportunities. It is difficult to predict which is the better approach, but future evaluation of the OZ program (as well as more research on past economic development programs) can help identify best practices and challenges in implementing these types of place-based policies.

Chapter 3: A Deep Dive into Opportunity Zones Benefits & Challenges

Understanding the broader community development context in which OZs fit is important to anticipating how OZs might unfold throughout the course of the program. As of spring 2019, OZs are still in an early stage of implementation. While there is a lot more to be learned about OZs, the program has generated significant interest and excitement among investors, developers, and community development advocates. This chapter highlights the key benefits that make OZs a noteworthy moment in this country's economic development efforts as well as outlines the challenges that may limit the program's abilities to deliver on its long-term policy goal.

ORIGIN OF THE OPPORTUNITY ZONE IDEA

The creation of the federal OZ program was cemented in the passage of the Tax Cuts and Jobs Act (TCJA) in December 2017; however, the origins of the OZ idea began long before it became known to most people interested in economic and community development. As stated in Chapter 2, OZs build on many previous concepts in place-based economic development policies over the last several decades. Perhaps what makes OZs different is that this is an investor-led, market-driven approach to revitalizing the country's most economically distressed communities. As such, the origin of the idea and the advocacy taken to ensure its passage relied heavily on private actors who built bipartisan support for OZs over time.

Those familiar with OZs often rely on resources from the Economic Innovation Group (EIG), a bipartisan research and advocacy organization, responsible for championing OZs. EIG was founded in 2013 by Sean Parker, former founder of Napster, John Lettieri, a government affairs professional, and Steve Glickman, former Senior Economic Adviser to President Obama. The group was founded to develop research and advocate for public policies that addressed economic inequality in the United States. EIG developed a paper titled “Unlocking Private Capital to Facilitate Economic Growth in Distressed Areas,” which became the basis for the OZ idea. The paper argues that recovery after the Great Recession occurred relatively quickly in some areas while others continued to languish with high rates of poverty and unemployment (Bernstein & Hassett, 2015). Parker, who served as the founding president of Facebook, realized that many wealthy investors (including himself) were sitting on millions and billions in unrealized capital gains. Low-income communities need capital to jumpstart their economies and revitalize their communities. So, one of EIG’s early projects was figuring out how to pair these wealthy individuals with the kinds of equity investments that distressed communities needed. The paper analyzed past federal economic development programs including EZs, ECs, RCs, and NMTCs, stating that past programs suffered from too much complexity, burdensome government restrictions, and weak incentives (Bernstein & Hassett, 2015). Given past weaknesses, Bernstein & Hassett proposed a new program allowing investors to more easily pool their investments and utilize their unrealized capital gains to benefit distressed communities. This, of course, became the foundation for OZs.

With the idea developed, OZs found bipartisan support in Congress from Senators Tim Scott (R-South Carolina) and Cory Booker (D-New Jersey). Parker pitched the idea to other billionaires, including Steve Case and Jim Sorenson, and developed a powerful coalition to build support among legislators. By the end of 2016, there was extensive bipartisan support for a bill introduced by Scott and Booker in the Senate and its companion in the House carried by Pat Tiberi (R-Ohio) and Ron Kind (D-Wisconsin) (Bertoni, 2018). The Investing in Innovation Act (IIOA) was originally introduced in 2016 at the end of the Obama administration, but got caught up in Congress during the election. A year later, IIOA was attached to the major tax reform bill, which was not only politically contentious but also likely to pass because of Republican support in both chambers. Rather than move a standalone bill through a gridlocked legislature, Scott saw an opportunity to push OZs through by attaching it as a provision of the TCJA. OZs had support from top leadership in both the White House and Congress. Eventually the TCJA, including OZs, passed the House with a 227-205 vote and the Senate with a 51-49 vote. Thus, OZs were born.

Anticipated Benefits of Opportunity Zones

In today's partisan political environment, bipartisanship is rare. What is it about OZs that garners bipartisan support? A free market solution that is economically attractive to wealth investors with the potential to move billions into distressed communities could be a win-win for all. OZs could offer several key benefits, including: 1) significant untapped private capital for distressed communities, 2) attractive and accessible tax benefits to investors, and 3) local flexibility to tailor projects and investments to community needs.

- <u>Untapped capital for distressed communities</u>: Estimates from EIG indicate that there is over $6.1 trillion in unrealized corporate and individual capital gains (EIG, 2018a). Though no one expects the totality of those gains to be invested in OZs, even a fraction of that amount invested in low-income communities could jumpstart economic growth in a substantive way. As a comparison, the NMTC program has distributed $23 billion in tax credits since 2003 (Tax Policy Center). Between 1993 and 2009, the federal government authorized a total of $1.78 billion in grant funding for the EZ, EC, and RC programs (Congressional Research Service, 2011). Identifying the exact amount of tax incentives allocated towards the EZ/EC/RC programs is more difficult because of a lack of program data and accountability reporting; however, the GAO (2010) estimated allocations of over $600 million in bonds for large-scale construction in EZs, over $1.7

billion in tax deductions for rehabilitation projects in RCs, and $675 million in employment credits in EZs and RCs. The scale of potential investments in OZs is of a different magnitude than what has been available for previous federal economic development programs. Treasury Secretary Steve Mnuchin believes that $100 billion in private capital investments is more likely in OZs (U.S. Department of the Treasury, 2018). For distressed communities, this level of investment could be significant enough to make inroads into entrenched social and economic challenges that held back the area for decades. Given the government's decline in public investments, turning to private capital to fill the gap could offer a major win for distressed communities.

- Attractive and accessible tax benefits for investors: One of the criticisms of past economic development programs was that they were too complicated and burdensome for investors. For example, the NMTC program required investors to make equity investments in CDEs, which received tax credits from the CDFI Fund and made separate investments in low-income communities. The administrative apparatus required to move private capital from investors to local communities and residents was clunky. Investors, who tend to be risk averse and unwilling to consider investing in low-income communities, could be turned off by the idea of navigating regulatory and bureaucratic hurdles. OZs removes many of those administrative burdens that characterized previous programs. Investors can invest in Opportunity Funds (OFs), which then make equity investments in OZs. 90% of an OF's assets must be held within an OZ. The requirements for OFs are relatively simple compared to those of previous economic development programs, which were often criticized for being too clunky and complex for investors and fund managers. Table 3 shows the requirements of Opportunity Funds, as of spring 2019.

Requirements for Two Basic Opportunity Zone Fund Structures

	Opportunity Zone Fund Invests in Opportunity Zone Businesses	Opportunity Zone Fund Directly Owns Assets in an Opportunity Zone
Asset Test	At least 70% of an opportunity zone business's *tangible* property (e.g., real estate or equipment) must be located in an opportunity zone.	At least 90% of the fund's assets must be located in an opportunity zone.
Income Requirement	At least half of the opportunity zone business's income must be "derived" from the "active conduct of a business" in the zone, as opposed to investors merely (that is, passively) holding assets (though the Treasury Department will need to further define these terms).	No such requirement.
Intangible Property Limitations	There is no overall limit on the amount of intangible property (e.g., intellectual property) that the opportunity zone business can own, but a "substantial portion" of its intangible property must be used in the "active conduct of a business" in a zone (though Treasury will need to further define these terms).	Only up to 10% of a fund's property (and any cash and property that's not located in an opportunity zone) can be intangible property, but there is no requirement that a percentage of a fund's intangible property be related to the active business of the fund.
Financial Property Restrictions	The opportunity zone business can hold a "reasonable" amount of cash — in fact, more than 30% of its assets, which would override the asset test described in the first box in this column — if the business shows that it has a plan for spending the money and uses the funds within a specified time period.	Cash (together with any intangible assets and any assets located outside the opportunity zone) can't exceed 10% of the fund's assets.
Prohibited Activities	An opportunity zone business may not operate certain "sin" businesses (golf courses, liquor stores, spas, etc.).	Opportunity zone funds may operate sin businesses directly (rather than owning a company that runs a sin business).
Treatment of Movable Property	Movable tangible property (e.g., cars or boats) that an opportunity zone business removes from an opportunity zone can still count toward the asset test for 5 years.	This rule does not appear to apply to property that a fund holds directly. That is, property removed from an opportunity zone no longer satisfies the asset test.

Table 3: Requirements of Opportunity Fund Structures. Source: Jacoby, 2019.

The process to set up OFs is straightforward, requiring self-certification through a two-page form from the IRS. Investors can invest and divest in OFs similar to how they might in non-OF investment funds. By investing in OFs and qualified OZ investments, private investors can unlock several significant tax benefits. Figure 1 highlights the key tax benefits associated with OZs.

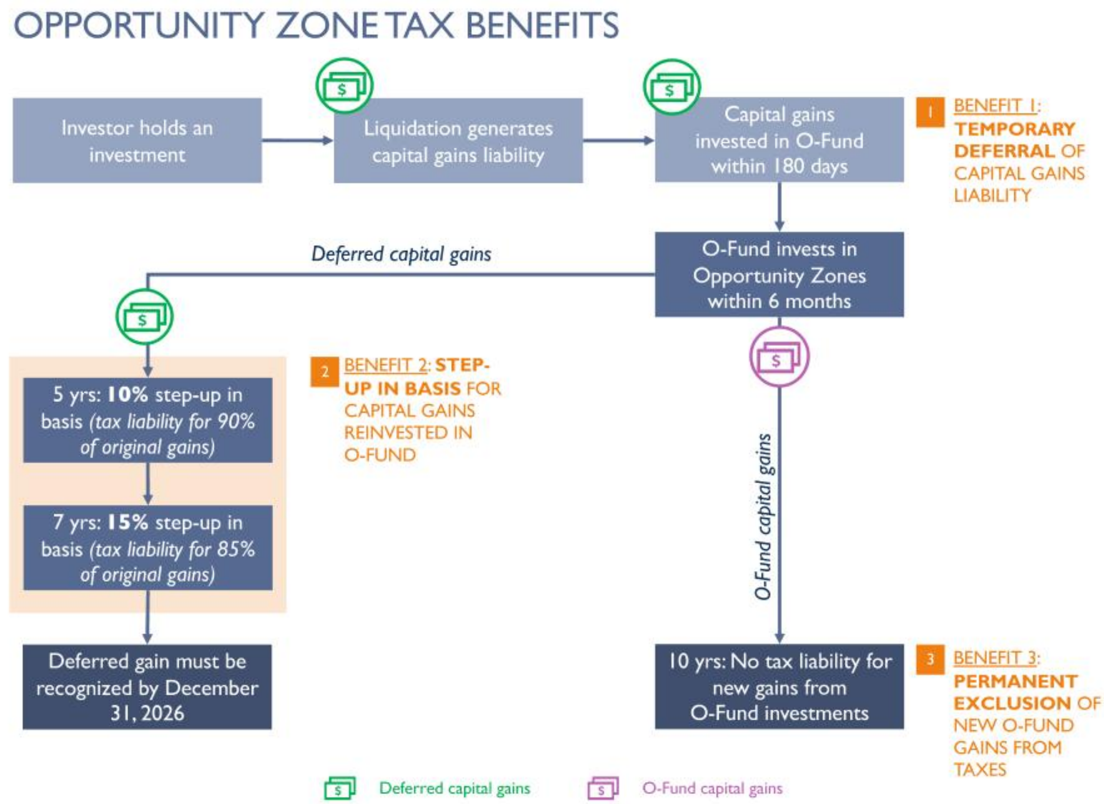


Figure 1: Summary of Opportunity Zone Benefits. Compiled by author.

The first tax benefit for investors is a temporary deferral of tax liability on capital gains from investments. Investors can delay paying taxes on capital gains from sold investments until 2026. Second, investors can reduce the amount of tax liability on deferred gains if they hold investments in OFs for a certain amount of time. At five years, investors receive a 10% step-up in basis on those original gains, reducing capital gains tax liability to 90% of the original value. At seven years, investors receive an additional 5% step-up so that they are only liable for tax on 85% of the original value of their deferred gains. For example, an investor with $100,000 in capital gains can defer paying taxes by investing in an OF. If the investor keeps his or her investment in the OF for five years, he or she is then liable for taxes only on $90,000. If he or she holds the investment for seven years, then taxes only need to be paid on a $85,000 basis in 2026. If additional capital gains are generated by the investment in the OF, investors do not pay taxes on those gains if the investment is held for 10 years. All in all, these incentives can be significant for some investors, and the flexibility in setting up OFs ensures that they can more easily move their money into communities most in need.

- Local flexibility to address community needs: Finally, OZs offer flexibility for investments and projects to be tailored to local needs. Investors, community development advocates, and local governments have the flexibility to structure their OZ strategies in many different ways. OFs can be set up for a variety of purposes ranging from specific geographic targets to specialization in types of projects supported. Community development advocates can pitch projects to investors that address important local needs. Municipal governments have flexibility to educate their residents on OZs, attract investors for different projects, and layer on additional incentives for development aligned to their priorities. Because there are few requirements at the federal level, there is a lot of flexibility for many different approaches to develop across OZ communities. Economically distressed areas differ in their needs and challenges. Simplified administration and fewer requirements allow for greater customization on the local and state level. This also built support for OZs among governors and mayors interested in taking advantage of this opportunity.

POTENTIAL CHALLENGES & CONSEQUENCES OF OPPORTUNITY ZONES

Even with significant benefits and bipartisan support, OZs also have numerous challenges and potential consequences that may hinder the program's ability to meet its policy goals. It is important to note that OZs are still unfolding, as the market is continuing to form and come into shape; however, for as much support as OZs garnered among policymakers, it has raised significant concerns among community advocates and hesitancy from investors. Many fear that OZs are nothing more than a tax shelter for the wealthy. OZ incentives are designed to benefit investors, but not necessarily the communities that need the capital. To some extent, the challenges and criticisms of the OZ program are not unique. Many of these risks apply to previous economic development programs and strategies; however, calling attention to these challenges is important to ensuring that the government considers these issues in the early stages of OZ implementation. Primary criticisms of OZs include: 1) the potential for investments to flow to areas and projects that would already be funded, 2) risk of exacerbating gentrification or displacement, and 3) the lack of reporting requirements and accountability mechanisms.

- Potential for investments to flow to areas and projects that would already be funded: Investors are motivated to seek investments with economic return, and the easiest way to ensure that their investments will result in profits is by going to areas that are already gentrifying. There is evidence to show that some states intentionally designated OZs where economic conditions were already improving or expected to gentrify (Gelfond & Looney, 2018). If the point is to direct investments towards the most economically distressed communities, then the OZ program is not narrow or specific enough in its mandate. The level of distress and need across 8700 OZs varies widely, and it behooves investors to put their money into areas already on the rise. A high-profile example of the flaw in OZ designation was Amazon's proposed HQ2 in the Long Island City area of New York. Had Amazon decided to build its second headquarters there, the company could have set up an OF to purchase real estate for and around their proposed offices; however, the company indicated that it would choose not to seek OZ incentives for their proposed NYC HQ2 (Melby & Leatherby, 2019; see also, Tankersley, 2018; Melby, 2019). Other communities, particularly in attractive urban markets, designated

OZs that currently meet the poverty requirement of the program, but are already attractive to investors and developers due to factors such as proximity to urban centers, access to talent, and growing population. Because communities must compete with one another for investments, "superstar cities" such as Los Angeles and NYC will be pitted against smaller communities such as Cleveland and Rochester (Charles, 2019a). Naturally, investors will be motivated to move their money to larger cities, where they can expect their investments to grow and where there is less risk and uncertainty. So far, anecdotal evidence questions whether the OZ market is targeting the most economically distressed communities or if investors are drawn to areas that were already attractive (Grant, 2018; see also Hall, 2019).

- Risk of exacerbating gentrification or displacement: If OZ investments are flowing to areas that are already improving, then additional private capital can facilitate more development that will attract higher income residents and displace low-income residents currently residing in the OZ. Evidence from past federal programs demonstrate that improvements in the economic conditions of distressed areas are often due to changes in the resident population, not improvements to the lives of low-income residents who resided in the area (Freeman, 2012; GAO, 2006). The same risk exists for OZs. The law and subsequent IRS regulations do not require any guardrails to protect current residents from displacement. While the program claims to be designed to benefit the nation's most economically distressed communities, one of the main tax benefits for investors is "ultimately dependent on rising property values, rising rents, and higher business probability" (Looney, 2018). To receive the full suite of tax benefits, investments made into OFs must appreciate in value, resulting in an exclusion from capital gains tax for investments held over 10 years. Investors benefit if their investments in OFs appreciate and generate additional capital gains; therefore, it is economically more attractive to invest in areas where gentrification will likely occur (or is already underway). Though value creation in low-income communities is desirable, it comes with the risk of displacing residents and benefiting the wealthy. Adding requirements to preserve housing or employment for low-income residents could help mitigate the risk of displacement, but policymakers and regulators have not required investments to do so.

- <u>Lack of reporting requirements and accountability mechanisms</u>: The GAO (2010) found that a lack of data collected about the EZ, EC, and RC programs hindered their ability to draw conclusions about the effectiveness and impact of those programs. Given this lesson, it is important for the IRS to mandate some kind of reporting requirement for investors and OFs to understand the types of investments made and benefits generated for the community. The problem is that, after two tranches of IRS regulations and guidance, there are no reporting requirements for OZ investors. OZs are meant to be simpler for investors than previous programs, but collecting no data about how much capital has been deployed, specific investments made, and outcomes from investments is a missed opportunity (Bloomberg Editorial Board, 2019a). There is no accountability mechanism to ensure that investments actually benefit communities. There is no way to know if the OZ program is effective unless the IRS requires funds to disclose information and report data on a regular basis. A group of impact-minded organizations jointly developed the Opportunity Zones Reporting Framework as a model for how fund managers should track and report on basic information such as fund demographics, transaction data, and community impact (U.S. Impact Investing Alliance, 2019). Impact investors are encouraging the widespread adoption of the framework, but a voluntary, opt-in system of accountability is unacceptable. Even after significant public comments and the introduction of the framework, the IRS refused to develop any reporting requirements for the program. Currently, the IRS is seeking more public input on what kinds of data they should collect about the program, but investment deals in OZs are moving ahead in the meantime. From a government accountability standpoint, taxpayers should want to know, at the very least, if this program is effective and if it achieves the goals that it intends to do.

Chapter 4: Early Opportunity Zone Strategies for Texas Communities

Communities across the country are thinking about OZs or devising strategies to attract investment and respond to investment interest. The focus of this chapter is on the role of local government in OZs. Without a formal role in the OZ program, local governments are in a position where they must respond to policies created at a federal level with significant impact on their jurisdictions and residents. Some communities are proactive in their approach to attract investors to their communities while others are in a reactive mode, only responding to inquiries that come to their attention.

To better understand how different communities are developing their OZ strategies, I conducted interviews with local- and county-level economic development leaders across Texas. These individuals either worked in city government or at an economic development corporation, which are quasi-governmental organizations focused on promoting economic growth in a region. Interviews were conducted with a subset of communities in Texas to hold constant state-level policies and context for OZ development. This chapter highlights different strategies that these communities in Texas are taking in response to the federal OZ program. Findings are based on interviews with representatives across the following Texas cities: Austin, Brownsville, Dallas, Houston, Lubbock, Orange, San Antonio, Texarkana, and Tyler.

TEXAS OPPORTUNITY ZONE DESIGNATION PROCESS

All governors were responsible for submitting nominations up to 25% of their eligible low-income communities to be designated as OZs by the Treasury/IRS. Governor Abbott designated 628 OZs across 145 counties in Texas with a large concentration in rural East Texas and areas that were impact by Hurricane Harvey. A map of Texas OZs can be found in Appendix C. The governors had flexibility to develop their own set of criteria and processes for determining which areas of their state should be designated as OZs. In Texas, the governor's office stated that they used a "multi-step process" that included consideration of an area's unemployment rate, population, and "significant economic disruptors" such as Hurricane Harvey (Fechter, 2018). Overall, Governor Abbott chose to prioritize rural communities, with over 60% of Texas OZs in partially rural areas, and parts of the state recovering from hurricane disaster.

Interviews with city officials across the state indicated that some (but not all) were invited to submit nominations of OZs to the governor's office for submission. Some took this opportunity to nominate specific Census tracts aligned to their city's broader economic development priorities. In most cases, the tracts submitted by cities were approved by the governor's office; however, there were instances where the governor chose to designate tracts not submitted by cities, and other times when he chose not to approve tracts nominated by cities. For example, the City of Austin suggested four Census tracts for OZ designation to the governor based on the city's priorities to develop healthy food options in the southeast portion of the city. Those tracts were approved by the governor's office along with another 17 OZs across the city. Similar situations occurred in Brownsville and San Antonio, and it is unclear what rationale the governor's office used to approve of tracts not submitted by cities or disapprove of tracts that were nominated.

Not all cities nominated Census tracts to the governor's office and instead found out about their OZs only after the governor submitted his preferences to the Treasury/IRS for final approval. Some cities did not realize that they could submit nominations to the governor's office while others were less aware of the OZ program overall. Because of the variation in knowledge and involvement among cities during the nomination process, different communities responded to and developed strategies around the OZ program.

Contextual Differences between Urban vs. Rural Areas

As a market-driven incentive program, OZs only benefit low-income communities if investors find attractive deals and believe that the market can provide them with economic returns. There is no guarantee that designation as an OZ will lead to investments, and not all OZs are equal in their ability to attract investors. Some communities will naturally attract investors because they are poised for growth and have the physical infrastructure, talent pool, and economic incentives needed for profitable investments. Other communities may struggle to attract investors because their markets are less developed or perceived as riskier. Where a community falls along this continuum will determine what priorities and strategies they adopt to capitalize on OZ benefits for their residents and businesses.

For large, urban communities, investments may flow more easily. Investors and developers tend to gravitate towards these larger communities that are more likely to generate economic return. People are moving to cities and their surrounding suburbs for jobs and other opportunities. Between 2017 and 2018, the Dallas-Fort Worth metropolitan grew at a rate faster than any other area in the United States (Ura, 2019). Texas is home to six of the top 20 largest cities in the country, and many of these cities regularly top lists of the fastest growing communities across the nation (Rosenberg, 2018). Texas cities, in particular, are attractive markets for investors who want to take advantage of a business-friendly climate and developers who want to meet resident demands for housing and other real estate needs. The state consistently ranks in the top five states to do business due to its a lack of an individual income tax and corporate tax well as generous tax incentives from local and state governments (Cohn, 2018). Under Governor Rick Perry, Texas offered $19 billion in incentives to businesses each year, more than any other state in the country (Story, 2012). This does not mean that economic growth has benefitted all residents equally, as there are still many communities with disproportionate and entrenched social and economic challenges. Overall, the largest metropolitan areas in Texas are growing and continue to attract investments, development, and new residents every day. OZ incentives could sweeten the deals for investors already looking to move into these urban markets.

While urban communities are poised for further growth under the OZ program, small and/or rural communities may have more difficulty leveraging OZ incentives, especially without proactive efforts from municipal leaders to attract investors. Nationally, over 40% of OZs are rural communities, but OZ observers believe that it will take more than the tax incentives to move private capital into distressed areas with deep-seated social and economic challenges (Farmer, 2019). Since the Great Recession, economic recovery in rural and small communities lagged behind that of larger urban centers. Efforts to revitalize small communities ranging from direct public investments to tax incentives vary in their effectiveness; however, some believe that employment-focused incentives may generate the most positive social and economic benefits (Austin et al., 2018). Tax incentives alone are often not enough to draw risk-averse investors to smaller, rural communities (Peters & Fisher, 2004). Investors look for low-risk, high-return investment opportunities; therefore, investments in rural communities may not be as attractive when compared to the potential return offered by investments in larger urban markets. Over 60% of Texas' OZs are partially or fully rural; therefore, municipal governments in rural areas or the state government will need to step in with additional incentives to ensure that capital reaches rural communities in need.

STRATEGIES FOR LARGE, URBAN COMMUNITIES

Interviews with city officials in large communities across Texas indicate that cities not only benefit from investor attraction but also resources to develop strategies around development in their OZs. Larger cities have in-house economic development staff that can develop knowledge and expertise about OZs. Even in the absence of a city economic development department, large cities also benefit from a network of investors, developers, community development corporations (CDCs), and others who are aware of and working on OZ issues. For example, the Coasis Coalition based in Dallas is a broad, cross-sector group of investors, developers, fund managers, businesses, and public institutions interested in OZs. The coalition hosted a conference in April 2019, attracting people interested in OZs from across the country. Having this level of expertise in one's backyard is a huge boon to large, urban cities. Other approaches taken by Texas cities include:

- Convening and aligning internal and external stakeholders: Several Texas cities, most notably San Antonio and Houston, have taken the lead in convening stakeholders across city departments as well as cross-sector working groups to develop OZ strategies that work for both investors and communities. The City of San Antonio is currently convening two key groups: 1) a technical working group with representatives across nine different city departments, and 2) an external advisory group with CDCs, redevelopment authorities, investors, developers, and tax attorneys. The purpose of these groups is to help city economic development staff build expertise around OZs, facilitate coordination of city processes around developments in OZs, and create a forum for investors and communities to communicate their needs and goals for OZ projects. The City of Houston adopted a similar approach by convening over 80 stakeholders for a forum on OZs, which led to the creation of a cross-sector working group that meets weekly to develop a citywide OZ strategy. This working group now has subcommittees focused on marketing high-priority projects to potential OFs and investors as well as engaging landowners and business owners currently in OZs. By convening advisory and working groups, cities can build relationships with different stakeholders who have an interest in OZs. An additional benefit to convening a broad group of stakeholders is that economic development staff can become more aware of OF investments in their city. Officials across multiple cities stated that they did not have a formal process to track and monitor OF investments in their cities. Because not all development deals flow through the economic development department, officials only become aware of OF deals that proactively come to their office for additional incentives or support. Others learn of OF deals from colleagues in other departments who manage other aspects of city development such as zoning or permitting. One city official learned of an OF investment by attending an event on OZs where a panelist spoke of a deal in their city. By convening broad stakeholder groups, cities can not only collaborate on citywide OZ strategies but also stay abreast of OZ activity among investors and others. City staff become more aware about the latest information on OZs, deals occurring in their cities, and ways to further incentive investments that support city priorities.

- <u>Layering local and state incentives for OZ projects aligned to city priorities</u>: Cities that naturally generate investor interest have more leeway to offer additional layers of incentives for projects in high-need communities or for development that is wanted by community stakeholders. A risk with the OZ program is that investors can completely bypass community engagement to build projects that may not address community needs. Because larger communities are not necessarily starved for investment overall, cities have some level of flexibility around adding incentives to help direct OZ investments towards community priorities. The City of San Antonio is also working to expedite zoning and permitting processes for projects that are aligned to the city's long-term strategic plan or located near 13 regional economic development centers prioritized for development. For larger cities, the challenge is not attracting investments, but instead guiding investments towards city priorities. Offering additional incentives and support from city staff for high-priority projects is one way that larger communities can sweeten the deal for investors while also addressing community needs.

- <u>Developing an investment prospectus to attract investors for high-priority OZs</u>: Accelerator for America, an organization founded by Los Angeles Mayor Garcetti, focuses on innovative economic development strategies at the local level. They developed and championed an OZ Investment Prospectus guide to support cities "communicate the distinctive assets and advantages of their selected Opportunity Zones and, to the greatest extent practicable, tease out specific investable projects and propositions" (Katz et al). The City of Houston released an investment prospectus in May 2019 highlighting the city's investment priorities in affordable housing, retail development/food deserts, manufacturing, tech innovation, and community development (City of Houston, 2019). A few other city officials indicated that they would also like to develop a formal investment prospectus in the near future. Thus far, Dallas and San Antonio have prepared various communications tools, including one-pagers and PowerPoint presentations on the types of investments and development that they hope to see in their OZs. Developing an investment prospectus provides cities with a proactive way to attract investors to projects vetted by the city and community.
- <u>Providing OZ information to interested stakeholders</u>: Finally, several Texas cities, including Austin, Dallas, and Brownsville, currently conceive of the city's role as an informational source for investors, community members, and others interested in OZs. The Austin City Council passed a resolution in October 2018 directing the city's economic development staff to research the city's OZs, identify best practices from other city governments, and highlight any additional incentives that may be used to

guide OZ investments in Austin. Dallas has provided general information on the OZ program through its website, mapping tools, and briefings to their city. To some extent, all city economic development departments are taking an educational approach to OZs by providing data on their OZs, keeping track of changes in the IRS' guidance and regulations, and fielding calls from interested parties about the OZ program. This informational function can be useful to both community members and investors who may be less familiar about the city's OZs or how the OZ program may impact communities overall.

STRATEGIES FOR SMALL, RURAL COMMUNITIES

While larger, urban cities in Texas have adopted a variety of early approaches to developing their OZ strategies, smaller, rural areas in Texas have seen little to no activity in their OZs. This is not because there is a lack of interest in making OZs work for smaller, rural areas of the state. As discussed in earlier sections of this report, rural communities across the country face greater barriers to attracting investments in their OZs, which are less able to generate the kinds of economic returns that investors are seeking. Representatives from smaller communities in Texas, including Texarkana, Tyler, Orange, and Lubbock indicated that they were not aware of any investment activity in their OZs, and some questioned whether they would be able to attract OZ investors at all. Several economic development officials in these cities indicated that they have to weigh the costs of committing staff resources towards understanding OZs and attracting investors with the potential (but not guaranteed) benefit of additional investments. Given more limited resources and fewer staff dedicated to economic development, staying up-to-date on OZs and finding investors can be a burdensome task for smaller communities.

Unlike large city government, smaller communities may not have municipal staff dedicated to working on economic development issues. In these communities, economic development corporations (EDCs) can play an important role in facilitating projects and finding investors, but even then, the EDCs tend to be small and understaffed. Given the legal and tax complexities of the OZ program, having technical assistance and resources to parse through information about OZs and how they can work in smaller communities is invaluable. One interviewee stated that figuring out how to make OZs work for small and rural communities would require hiring an additional full-time staff person to work only on OZs. While this is possible for a large city government with an entire economic development department, smaller communities need additional support to understand the technical underpinnings of the OZ program. To some extent, all communities, whether large or small, have had difficulties understanding how OZs would be implemented because of a lack of clarity in regulations from the IRS; however, larger cities have the resources to dedicate some staff time towards understanding their OZs and how the program may or may not benefit their communities. The economic development infrastructure in smaller communities is less extensive and more under-resourced.

Many small communities in Texas have assets that could be attractive to businesses and have priorities where development could significantly benefit their residents. For example, former military property in Texarkana is available to private investors and developers for redevelopment. There are thousands of acres of land available, and significant resources have gone to building industrial-grade water, electricity, and technological infrastructure over the last several decades. The community in Orange has identified a need for healthcare facilities that could benefit from OZ investments. Many of these areas have mayors and city councils that support OZs and want to see investments benefitting their communities. Most of these communities have an EDC that can help facilitate development projects. The issue is not whether there are assets and potential projects in small and rural communities. The true challenge is figuring out how to attract investors in these distressed areas, making it economically viable and profitable for them to move their money into communities that are traditionally overlooked.

One way to attract investors to small, rural areas is by offering state-level incentives for rural investments. For example, West Virginia is considering an income tax exemption for OZ investments, Maryland is proposed a tax credit for OZ businesses that hire formerly incarcerate individuals, and Florida is overlapping OZs with their state enterprise zones to maximize benefits for investors (Charles, 2019b). Several bills in the 86th Texas legislature are proposing different state OZ incentives ranging from tax refunds for OZ businesses to offering tax credits to investors who invest in rural OFs and OZs. HB 1000 introduced by Representative Paddie proposes $35 million in tax credits against state insurance tax liability for investors who invest in rural funds and OZs (House Research Organization, 2019). The tax credits would be administered by the Texas Economic Development and Tourism Office (TEDTO), which would allocate credits through a competitive application process requiring investors to show investment activity and the number of jobs created through an OZ investment. Those receiving tax credits must submit an annual report about their investments and community impact to TEDTO. HB 1000 passed out of the Texas House of Representatives on April 16, 2019 with a 113-19 vote. At the time of the writing of this report, the bill has been sent to the Texas Senate and referred to the Senate Business and Commerce committee. If this bill passes before the end of the legislative session, it could incentivize investors to turn towards smaller, rural communities and make rural investment opportunities more economically attractive.

Finally, other states with disproportionately high rural OZ designations have generated interest in rural investments through OFs set up with the specific goal of targeting rural communities. The Rural COZ Fund in Colorado is an OF created to develop real estate projects in the state's rural OZs (Four Points Funding, 2019). Creating OFs with a targeted goal of investing in rural OZs is one way that investors and fund managers can move private capital into rural distressed areas. Many OFs are designed to support specific geographic targets or types of development projects. Investments in rural communities will likely not flow on their own. Instead, it may take state-level intervention to make rural investments more attractive, proactive efforts to attract investors to these areas, and focus from fund managers to support the needs of small, rural communities.

Conclusion

Since the passage of the TCJA in 2017, Opportunity Zones have generated a lot of buzz and interest from investors, real estate developers, economic development corporations, and community development organizations. As the first federal economic development program in decades, Opportunity Zones could generate billions in much needed investments for low-income communities. Unlocking private capital to benefit distressed urban and rural areas can foster economic growth, create jobs, and revitalize communities across the country.

Eighteen months into the program, Opportunity Zones continue to attract attention and debate within the economic development field; however, while interest may be high, the amount of investments made in low-income communities has been limited. This is due in part to delays in the release of regulations and guidance from the IRS, which administers the program. The National Council of State Housing Agencies (NCSHA)' Opportunity Fund Directory, which is an opt-in database, currently has over 100 listed funds totally almost $24 billion in potential investments. While many Opportunity Funds have been created, fewer dollars have made their way to communities. The first Opportunity Zone deal closed in Texas is a $16 million real estate development to construct a climate-controlled, self-storage building in San Antonio (Fechter, 2019). Investments in other cities included development of a luxury, multi-family apartment building in downtown Houston and continued interest in other real estate projects across the state's largest cities (Smith, 2019). Though interest is high, uptake has been slow. Some believe that investors want more clarity from the federal government before they jump in while others are unsure if tying their money up in long-term, potentially risky investments is worth the benefit (Browning, 2019). With a newly released second tranche of guidance from the IRS, some expect more investors to jump into the market over the coming months, especially because investments in OFs need to be made by the end of 2019 to qualify for the full suite of tax benefits (Rubin, 2019). If the assumption that a lack of clarity in federal guidelines kept investors at bay, then the additional set of regulations released in April 2019 could motivate more investors to seek OZ deals.

One of the biggest challenges of the Opportunity Zone program is the tight timeline for investors to unlock maximum benefits of the program. For those who wish to receive all of the program's tax benefits, their capital gains must be invested in an Opportunity Fund by the end of 2019. Those funds must make investments in Opportunity Zone projects within six months. Given continued lack of clarity in IRS guidance and the quick turnaround needed to move an investor's money into a qualified Opportunity Fund, expectations of significant investment in communities may be overstated. Investors will look for "shovel-ready projects" (mostly real estate development) where they can immediately put their money to receive tax benefits (Banister, 2018). Some of these projects may be beneficial to communities and their residents, but there is no guarantee that Opportunity Zone investments will go towards projects that communities want and need to improve the lives of their residents.

Based on evidence of past federal programs and trends in how Opportunity Zones have emerged thus far, the biggest lingering question is: who will benefit from Opportunity Zones? Clearly this is a program intended to benefit private investors, but the potential for community impact is less clear. Some critics of the program believe that the Census tracts designated as Opportunity Zones are not home to the country's most distressed communities, though the average poverty level and unemployment rate in these zones are higher than national averages (Jacoby, 2019). Many are concerned that the program is designed to offer investors flexibility in their investments, but is not strict enough in ensuring that investments result in tangible social and economic benefits to Opportunity Zone residents (Bloomberg Editorial Board, 2019a). One of the key challenges of past federal economic development programs was the level of complexity in program structure and burdensome requirements on investors (Bernstein & Hassett, 2015). In trying to reduce program bureaucracy and complexity, the Opportunity Zones program may have swung too far, as one of the chief criticisms of the program is the lack of requirements ensuring that investments deliver community benefits (Jacoby, 2019; see also Bloomberg Editorial Board, 2019b; Cornett, 2019). At the time of this report, investors and fund managers will not be required to provide any data about specific investment projects, jobs created, or other community benefits.

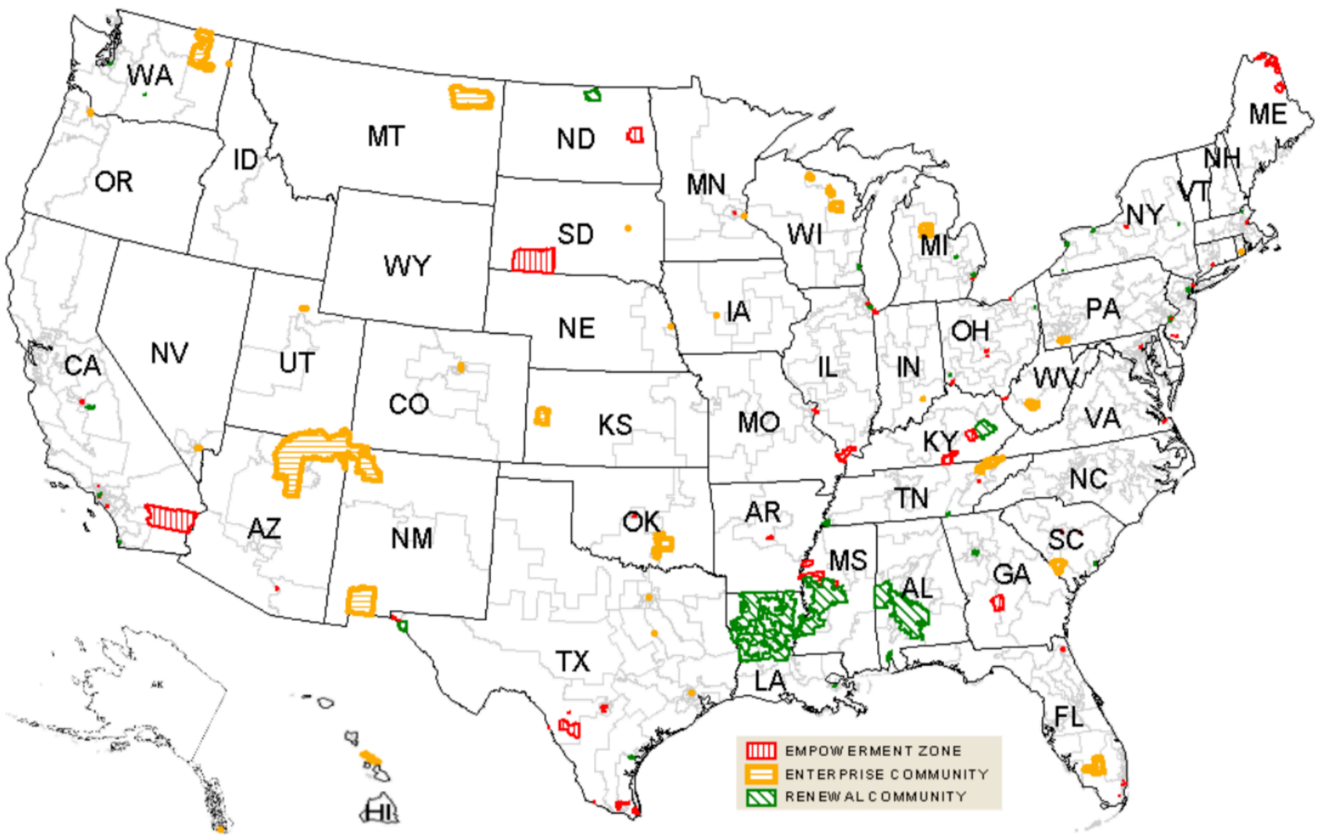
The Joint Committee on Taxation estimates the cost of the Opportunity Zone program will be $1.6 billion through 2027 (Buhayar, 2019). Given the hefty price tag, taxpayers deserve to know if this program will achieve its goals of revitalizing distressed communities. Many interest groups advocated to the Department of Treasury after the first tranche of regulations was released in October 2018 that, at a minimum, the department needs to collect basic information about Opportunity Fund investments such as projects supported, the amount of funding for each project, and where projects are located (Bloomberg Editorial Board, 2019b). Impact-minded investors even created a framework for transparency and accountability that would provide the public, policymakers, and future researchers with information needed to understand the true impact of Opportunity Zones (Seegull, 2018). Yet, no reporting requirements were mandated in the second tranche of regulations released by the IRS in April 2019. Meanwhile, investors and fund managers are seeking to invest in Opportunity Funds by the end of the year. Without this information, we may not be able to evaluate whether the Opportunity Zone program fulfills its original promise and whether or not this is an effective, efficient use of limited resources.

Moving forward, there are a few ways that local, state, and federal governments can improve the Opportunity Zone program so that it is more likely to result in community development. First, the IRS should take note of public comments advocating for additional reporting requirements and program transparency. There is already support in Congress for additional accountability measures. Senators Tim Scott and Cory Booker, the original supporters for Opportunity Zones, filed a bill in May 2019 that would require Treasury to collect additional information on Opportunity Fund investments, including fund holdings, job creation, poverty reduction, and growth of new businesses (O'Neal, 2019). This legislation could be strengthened by directly requiring an evaluation of the program at different milestones of the program and at the end of the program in 2026 or 2027.

Second, state governments can create additional incentive programs to attract investors to the highest need communities. One example is HB1000 in the 86th Texas legislature. Creating state-level incentives making investments in small-town, rural, or highly distressed urban communities more attractive to investors can help move capital toward areas that need it most. In the absence of federal reporting requirements, states can pass legislation requiring data transparency and accountability for investors seeking to invest in their state. Finally, local governments can influence investments in their Opportunity Zones in a variety of ways, including layering local incentives, collecting data on Opportunity Fund investments, and working with investors and fund managers to identify projects that deliver both economic return and community impact.

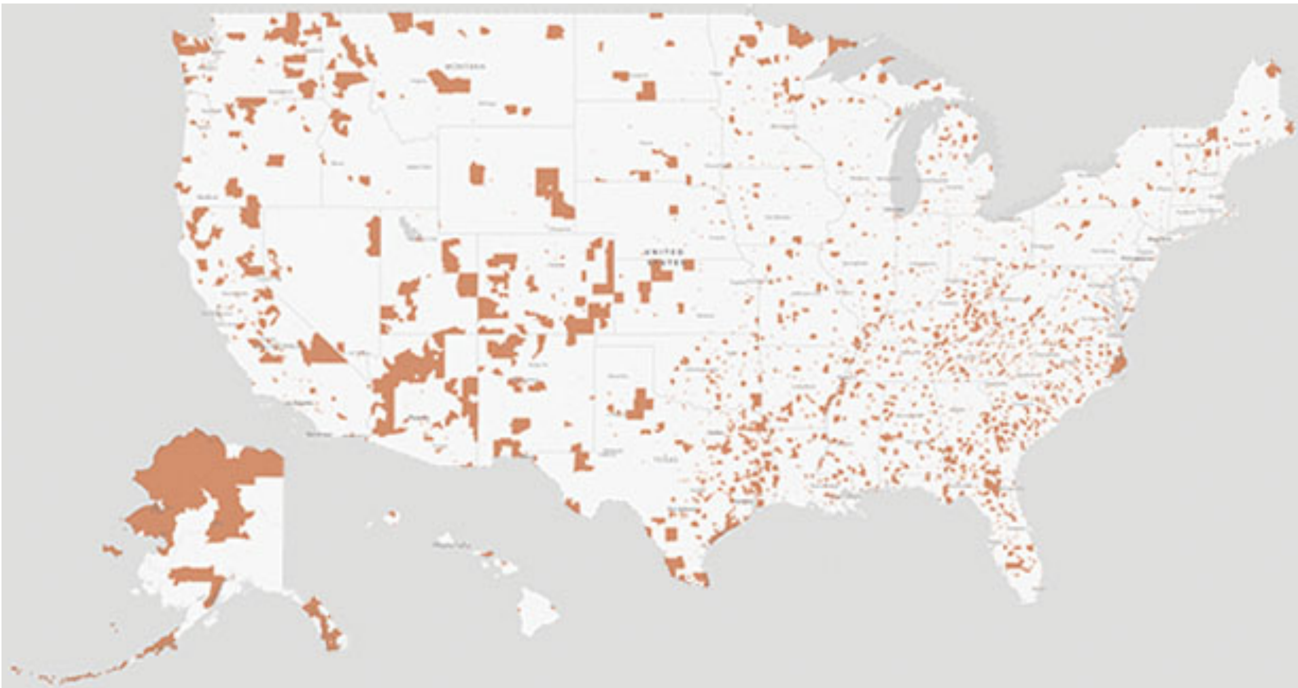
In conclusion, Opportunity Zones are significant and worthy of attention as the most recent, large-scale economic development effort in the U.S. in over a decade. Designed to incentivize private investors to invest in economically distressed communities, the program has significant potential to catalyze economic growth across the country. No program is perfect, and the devil is often in the details. The government can improve the likelihood of success by adding reporting requirements to the program and further incentivizing investments in the highest-need Opportunity Zones. Looking to past federal economic development policies for lessons about data collection and program structures can help inform improvements to the Opportunity Zone program and address potential shortcomings at an early stage of program implementation.

Appendix A: Map of EZs, ECs, and RCs



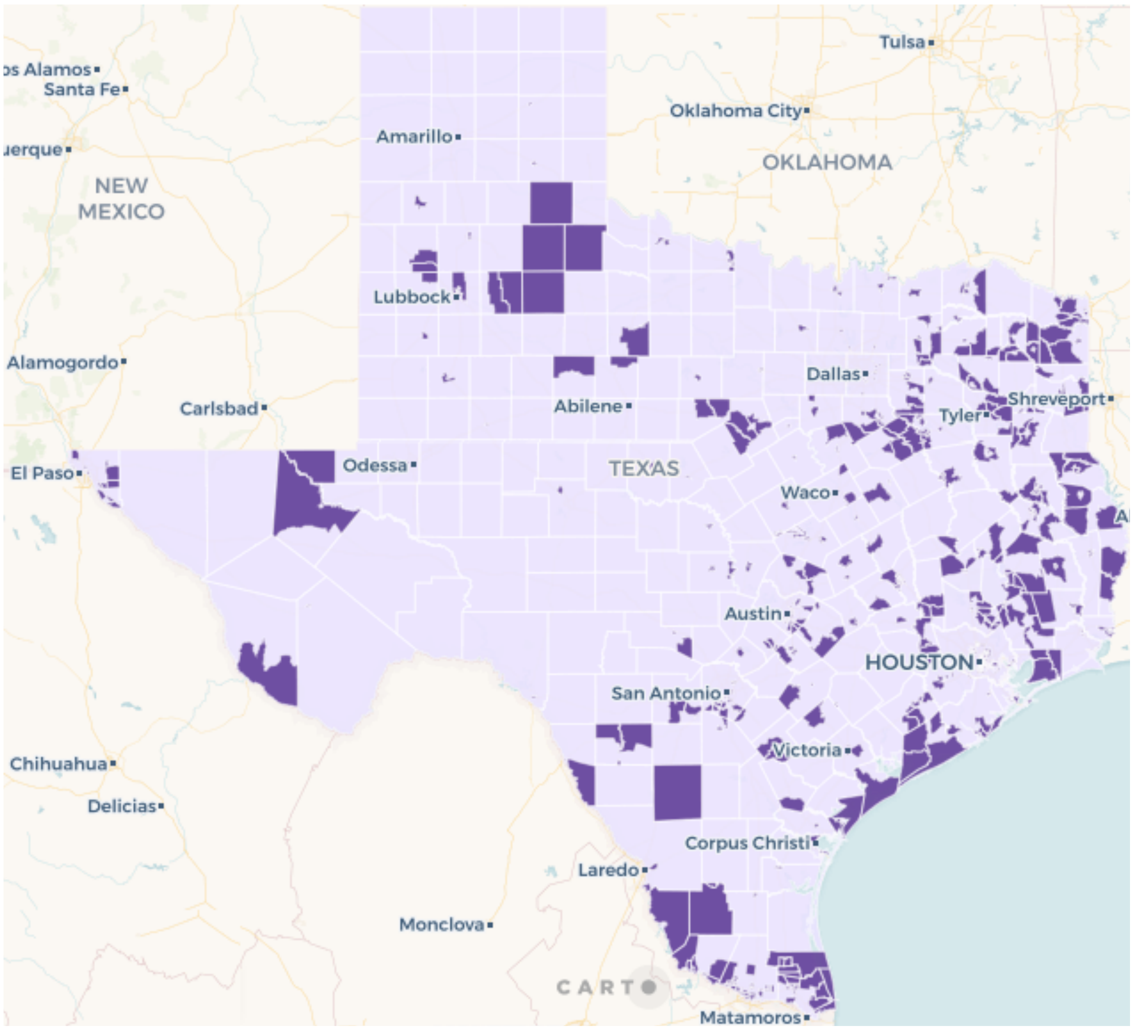
Source: Congressional Research Service, 2011.

Appendix B: Map of Opportunity Zones



Source: Economic Innovation Group, 2018b.

Appendix C: Map of Opportunity Zones in Texas



Source: Perlmeter, 2018. *Federal Reserve Bank of Dallas.*

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